

Title Holding corporation; leasehold interest in an office building. A corporation that holds a leasehold interest in an office building, derives all its income from subleasing space in the building to the general public, and turns over the net rents to its exempt parent qualifies for exemption under section 501(c)(2) of the Code.

#### ISSUE

Does the corporation described below, which holds a leasehold interest in an office building, qualify for exemption from federal income tax under section 501(c)(2) of the Internal Revenue Code?

#### FACTS

Corporation M was formed for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount, less expenses, to another organization exempt from federal income tax under section 501(a) of the Code. The sole asset of M is a leasehold interest in an office building. All of its income is derived from subleasing space in the building to the general public. M collects the rents from the subtenants, pays the expenses incident to operation and maintenance of the building, including its own rental costs, and turns over the remainder to its exempt parent. M renders no substantial services to the subtenants other than normal maintenance of the building and grounds.

#### LAW

Section 501(c)(2) of the Code provides for exemption from federal income tax of corporations organized for the exclusive purpose of holding title to property, collecting income from the property, and turning over the entire amount of income, less expenses, to an organization which itself is exempt from federal income tax under section 501.

Section 1.501(c)(2)-1(a) of the Income Tax Regulations provides that since a corporation cannot be exempt under section 501(c)(2) of the Code if it engages in any business other than that of holding title to property and collecting income therefrom, it generally cannot have unrelated business taxable income as defined in section 512.

Section 512(b)(3) of the Code excludes from the determination of unrelated business taxable income rents from real property.

Section 1.512(b)-1(c)(3)(i) of the regulations provides that, for purposes of section 512(b)(3) of the Code, the term "real property" means all real property, including property

described in section 1250(c) and the regulations thereunder.

Section 1250(c) of the Code provides that the term "section 1250 property" includes certain real property which is or has been property of a character subject to the allowance for depreciation provided in section 167.

Section 1.1250-1(e)(3) of the regulations provides that the term "section 1250 property" includes three types of depreciable real property. The first type is intangible real property. For purposes of section 1250 of the Code, a leasehold of land of section 1250 property is intangible real property, and accordingly such a leasehold is section 250 property. The second type is a building or its structural components. The third type includes other tangible real property.

Rev. Rul. 69-381, 1969-2 C.B. 113, holds that a title-holding company that derives income from the rental of real property to the general public is not precluded from exemption from federal income tax under section 501(c)(2) of the Code.

#### ANALYSIS

Section 501(c)(2) of the Code and the regulations thereunder contain no direct restrictions on the type or character of property that can be held by a section 501(c)(2) organization. Thus, such an organization can hold real or personal, tangible or intangible property, including a leasehold of real property. However, a corporation cannot be exempt under section 501(c)(2) if it engages in any business other than that of holding title to property and collecting income therefrom.

Rev. Rul. 69-381 holds that income from the rental of real property to the general public does not preclude exemption under section 501(c)(2) of the Code. In contrast, the rental of personal property is, in general, treated as the conduct of a business, and income from the rental of personal property will preclude exemption under section 501(c)(2). See Rev. Rul. 69-278, 1969-1 C.B. 148.

While a leasehold of real property is generally classified as personal property, see Powell on Real Property, section 221(2) (1977) and 1 American Law of Property, section 3.12 (1952), income derived from subleasing an office building is treated as income derived from the rental of real property under section 512(b)(3). See sections 1.512(b)-1(c)(3)(i) and 1.1250-1(e)(3) of the regulations. Such income is similarly treated as rental income from real property for purposes of section 501(c)(2).

Thus, M's subleasing of the office building to the general public is indistinguishable from the situation described in Rev. Rul. 69-381 for purposes of determining M's qualification for exemption from federal income tax under section 501(c)(2) of the Code.

## HOLDING

The organization described above, which holds a leasehold interest in an office building, qualifies for exemption from federal income tax under section 501(c)(2) of the Code.

## APPLICATION INSTRUCTIONS

Even though an organization considers itself within the scope of this revenue ruling, it must file an application on Form 1024, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(2) of the Code. See section 1.501(a)-1 of the regulations. In accordance with the instructions to Form 1024, the application should be filed with the District Director of Internal Revenue for the key district indicated therein.

